Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20054

In the Matter of	)	
	)	
Implementation of Sections of	)	
the Cable Television Consumer	)	MM Docket 92-266
Protection and Competition Act of 1992	)	
	)	
Rate Regulation	)	

Reply of the Fiber Optics Division, Telecommunications Industry Association

The Fiber Optics Division of the Telecommunications Industry Association ("TIA") hereby replies to the comments of others in the above-captioned proceeding.

In its Comments of January 27, 1993, TIA reviewed the cable industry's rapid pace in deployment of optical fiber and associated components. TIA surveyed the evolution of architectures beyond the original coaxial "tree-and-branch" distribution systems, designed to exploit fiber's large bandwidth, reliability for interactive (two-way) use, reduced need for signal amplification over long distances, and other advantages relative to coaxial cable. Such deployments, the Comments noted, could be upgraded cost-effectively to provide interactive broadband switched network services.[1]

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[1] In comments and reply comments in the so-called video dialtone proceeding leading up to the Second Report and Order, *Telephone Company-Cable Television Cross-Ownership Rules*, 7 FCC Rcd 5781 (1992), TIA provided similar information about the telephone industry's deployment of optical fiber trunk and loop networks. It explained the costs and benefits of upgrading the existing switched, interactive telephone voice and data networks to broadband video delivery capability. TIA urged in that docket, as it advocates here, that regulation be fashioned to permit greater degrees of both competition and cooperation in the public interest between cable operators and exchange telephone companies.

Because the legislative statement of policy in the 1992 Cable Act, Section 2(b), gave high priority to ensuring that cable operators "continue to expand, where economically justified, their capacity and the programs offered over their cable systems," TIA supported the Commission's view that the rate guidelines required by the Act should allow cable operators to justify higher rates if needed to recover prudent capital and operating expenses associated with fiber and other advanced network installations. (Comments, 11-17)

TIA's picture of cable industry improvements in channel capacity and reliability and of general technological progress is reinforced by other commenters, including Cablevision Industries Corporation (4) and Time Warner Entertainment (Attachment, Hatfield Associates study, 4). Virtually all parties, with a notable exception discussed below, support the opportunity for individual cable operators to justify higher rates if prudently related to the recovery of higher costs.

TIA's comments (18-19) also suggested that if basic service rates were to be kept low, as the Act's legislative history mentioned repeatedly, cable programming service rates should be afforded an ample range of reasonableness. Finally, TIA recommended (19-22) beginning the development of an "advanced technology cost-of-service" benchmark, even if this could not be implemented by the April statutory deadline. Discussion of these points in light of others' comments is taken up below.

The opportunity to justify above-benchmark rates based on prudent costs is allowed in the statute and required by the Constitution.

As noted above, the Commission's view (Notice, 40) that cost-of-service regulation could "have a place in our regulatory framework for cable operators seeking to justify rates higher than would be considered reasonable under the

benchmark standard we could adopt" is considered sound in law and policy by most commenters, including those outside the cable industry.[2]

Only NATOA would deny or severely restrict the cable operator's opportunity to demonstrate prudent costs creating a revenue requirement higher than some federally-selected benchmark. (Comments, 44-46) NATOA would make such a demonstration available only for operators below the benchmark, or at the rate-regulating authority's option.[3]

In its references to the use of cable system costs as guidelines for reasonable rates, the 1992 Cable Act does not limit their use to low-priced cable systems. As the Commission recognizes, cable operators charging above whatever benchmark is selected would have the greatest interest in demonstrating their legitimate capital and operating expenses. As recognized by the Conference Report on the Act, and by settled law of rate regulation, the cable operator must be accorded the opportunity not only to recover these expenses but to earn a reasonable return on them.[4]

To refuse the operator this opportunity would risk a "regulatory taking" of his property in violation of the due process and just compensation clauses of the

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[2] *See, e.g.,,* Comments of GTE, 10 and n.29; Comments of Austin, Texas and other cities, generally supporting a "normative cost"-of-service benchmark but acknowledging the legal requirement to accommodate "exceptional cases" of prudently incurred high costs, 12.

[3] NATOA's reading of the "effective competition" standard in the 1992 Act is similarly restrictive. Its assertion that the 15% penetration test of Section 623(l) may not be read cumulatively (Comments, 10), as the Commission proposes, improperly relies on a legislative history illustration in which there is but a single competitor to the incumbent dominant cable operator. The face of the statute expressly anticipates multiple competitors to the incumbent and explicitly permits their penetration rates to be cumulated toward the 15% threshold.

[4] H.R.Rep.102-628 at 63; *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (Although statutorily decided, this decision has constitutional dimensions. *Id.* at 607); *Jersey Central Power & Light Co. v. F.E.R.C.*, 810 F.2d 1168 (D.C.Cir. 1987).

Fifth Amendment to the U.S. Constitution.[5] The proving of costs is not merely a perquisite of the rate-regulating authority; it is a constitutional right of the regulated cable operator.

Several studies support differentiating basic and cable programming service rate regimes.

In its Comments at 18-19, TIA suggested that Congress' repeatedly expressed interest in low basic service rates could only be accomodated by a looser rein on cable programming service charges. Among the many commenters supporting the point, both TCI and NCTA -- through consultants' studies -- conclude that the Commission should focus on cable systems with rates in the 95th percentile and above in testing for unreasonableness.

In an attachment to TCI's comments, Charles River Associates finds that it would be not only consistent with the 1992 Act's differentiation of legal treatment for the two types of service, but sound policy, to distinguish controls on "expanded basic" from those on basic services:

> By using a much lighter hand to oversee the rates for cable programming services, the Commission will have created a "programming diversity" safety valve in the event that the rates for basic cable service are too constrained to permit the operators to profitably carry expensive but highly-valued satellite services on the basic tier. (42-43)

Noting that the 1992 Cable Act allows "rates as a whole" for all services and equipment to be taken into account in testing for unreasonabless of expanded basic rates, NCTA's consultant, Economists Incorporated, proposes creation of a

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[5] *Cf. Ruckelshaus v. Monsanto Co.*, 467 U.S. 986, 1005 (1984) (A factor in determining if there has been a regulatory taking is the economic impact of the action and its interference with reasonable investment-backed expectations.); *See also Pruneyard Shopping Center v. Robbins*, 447 U.S. 74, 83 (1980); *Kaiser Aetna v. U.S.*, 444 U.S. 164, 175 (1979).

basket of all regulated subscriber services and equipment yielding an average revenue number it calls B2. Systems having B2s of 95th percentile and above would be presumed to charge unlawfully high cable programming service rates. (16-24)

Not all commenters would differentiate regulatory treatment of the two types of services.[6] In TIA's view, to treat them the same fails to give sufficient account to the distinctions in the statute and to the emphasis in the legislative history on suppression of basic rates. To the extent that state regulation of local telephone rates is any guide -- and Congress' "lifeline" view of basic cable service supports the analogy -- the Commission can expect local authorities to be tempted to shift costs away from basic service. To compensate for such influences, and to carry out the Congressional desire that cable continue to innovate in programming, the FCC must give serious consideration to a standard for expanded basic services more flexible than the guidelines for basic service are likely to be -- at least as applied locally.

Despite widespread opposition, TIA believes cost-of-service methods are manageable if applied as a benchmark developed from reliable data.

TIA agrees with the Commission and the majority of commenters who cite administrative costs and litigation expenses as serious disadvantages for cost-of-service ratesetting methods. It does not agree, however, with those who analogize the cable industry to the historical telephone industry and fear the return of "Averch-Johnson" distortions on investment incentives.[7] In the first

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[6] *See, e.g.*, CFA, 99; City of Austin, attached study, 2.

[7] H.Averch and L.L. Johnson, "Behavior of the Firm Under Regulatory Constraint," *American Economic Review*, 1963, 1052-69. Where profit is related to a return on regulated investment, the

place, an express or implied rate of return to the regulated entity is never a guarantee, only an opportunity. If competition makes it impossible for a cable operator to earn a positive return on a too-inflated rate base, he will be circumspect and prudent in his investments. Thus the re-regulated cable industry must be distinguished from the historical telephone industry.[8]

Second, TIA believes that the study attached to the Comments of City of Austin -- referred to there as "Smith and Katz" -- demonstrates one way to create a cost-of-service benchmark that would alleviate the burdens of administration and litigation so shunned by the majority of parties here.[9] For example, in order to overcome the problem of lack of historical cost data for the cable industry in general and individual systems in particular, the authors propose to use "replacement costs" in their model. From TIA's perspective, if multichannel video distribution competition emerges as Congress hopes, replacement cost increasingly will reflect the capital and operating expenses of deploying advanced interactive broadband systems.

Subscribers will want to have, and come to expect, the services and conveniences such advanced systems can provide. Cable operators have told TIA vendors that they expect new-service revenues to help substantially in paying for

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regulated firm will favor capital over other inputs so long as the allowed rate of return is greater than the true cost of capital.

[8] Today's competitive conditions also put increasing pressure on capital investments with a purpose and promise of yielding new service and revenue opportunities. For the cable operator, this would include not only other-than-entertainment video offerings but also voice and data services. TIA repeats the view previously expressed to the FCC and state commissions, that cable companies should be allowed into voice/data markets just as telephone companies should be allowed into video service markets as providers and distributors.

[9] TIA does not necessarily support all the findings and conclusions of Smith and Katz or their client cities. It agrees, however, that "normative" costs increasingly can be identified with accuracy, whether solicitied by FCC questionnaire, as the authors suggest, or collected more informally from cable systems engaged in upgrades, rebuilds or new builds and willing to make cost data public.

upgrades and rebuilds, so that improvements in technology will not risk making existing offerings unaffordable.

Just as cable operators today are following, and in terms of percentage annual growth now outpacing, telephone companies in deployment of fiber technology, we can anticipate that all broadband distributors in the future will be pressed by competition (or threatened competition) into state-of-the-art deployment.

TIA does not expect a mandate for upgrades or rebuilds from either the federal government or local authorities. But where cities and states have called for the best available technology, the FCC's rules should encourage rather than stifle their desires. This can only occur if an inexpensive, easy-to-administer cost-of-service benchmark is devised. This won't happen in the next two months, but it should continue to be a goal of ongoing study and rulemaking at the agency, with the help of all interested parties.

CONCLUSION

For the reasons discussed above, the Commission should make clear to cable operators and franchising authorities that adoption of rate benchmarking does not preclude the optional use of cost-of-service ratesetting in appropriate cases. Rate guidelines should heed differences in statutory and legislative history language about the factors to be considered in regulating prices for basic services on the one hand and cable programming services on the other. If basic prices are to be kept as low as possible, the 1992 Act permits more flexible treatment of other-than-basic regulated offerings. Studies such as that submitted by City of Austin *et al.*, together with increasingly available cost data on advanced video distribution system deployments, should make possible eventually the development of a relatively simple and reliable cost-of-service benchmark using

costs and expenses associated with broadband interactive systems using optical fiber and other media.

Respectfully submitted,

Fiber Optics Division

TELECOMMUNICATIONS INDUSTRY ASSOCIATION

By Timothy J Regan

Jan H. Suwinski, Chairman
Fiber Optics Division
Timothy J. Regan, Chairman
Cable Infrastructure Committee
2001 Pennsylvania Avenue N.W., Suite 800
Washington, D.C. 20006
(202) 457-4934

OF COUNSEL:

James R. Hobson
Jeffrey O. Moreno
Donelan, Cleary, Wood & Maser, P.C.
1275 K Street N.W., Suite 850
Washington, D.C. 20005-4078
(202) 371-9500

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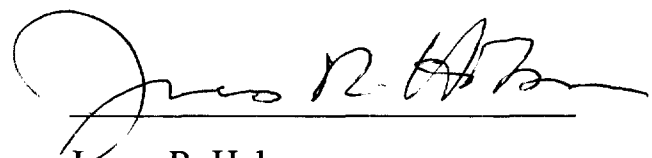
I hereby certify that copies of the foregoing Reply of the Fiber Optics Division, Telecommunications Industry Association, were on this date mailed postage prepaid or delivered by hand to all parties filing Comments in MM Docket No.92-266.



James R. Hobson